

Message Text

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17

ACTION ARA-20

INFO OCT-01 ISO-00 AID-20 CIAE-00 COME-00 EB-11 FRB-03

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FM AMEMBASSY GUATEMALA

TO SECSTATE WASHDC 4522

INFO AMEMBASSY TEGUCIAGLPA

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E.O. 11652: N/A

TAGS: ECON, GT

SUBJECT: FINANCE: MONETARY BOARD ADOPTS CONTRACTIVE POLICY

1. (BEGIN UNCLASSIFIED) THE MONETARY BOARD OF THE GOG ON SEPT.
27 ADOPTED EFFECTIVE OCT 1 A SERIES OF MEASURES DESIGNED TO SLOW
CAPITAL FLIGHT, DISCOURAGE INVENTORY BUILDING AND "DIRECT FUNDS
TO PRODUCTIVE" USES. THE MEASURES ARE: (A) INCREASE INTEREST
RATE BANKS ALLOWED TO PAY ON DEPOSITS FROM 6 PERCENT TO 9 PERCENT
AND INCREASE LOAN/DISCOUNT RATE FROM EFFECTIVE 9 PERCENT (8PER-
CENT PLUS 1 PERCENT FEE) TO 11 PERCENT (FEES NO LONGER AUTHORIZED)
WITH THE EXCEPTIONS THAT LOANS FOR BASIC GRAINS PRODUCTION AND
FINANCING OF SMALL BUSINESSES WILL REMAIN AT 5 PERCENT AND
8 PERCENT RESPECTIVELY (SUCH LOANS ARE FUNDED FROM BOG LINES OF
CREDIT). MONETARY BOARD CLAIMED THAT HIGHER DEPOSIT RATE WILL
DISCOURAGE CAPITAL FLIGHT TO HIGHER PAYING MARKETS
ABROAD AND HIGHER LOAN RATE WILL DISCOURAGE SPECULATIVE
BUYING. (B) INCREASE RESERVE REQUIREMENTS ON SIGHT AND SHORT-
TERM TIME DEPOSITS FROM 30 PERCENT TO 40 PERCENT OVER THREE MONTH
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PERIOD. RESERVE REQUIREMENT ON SAVINGS AND OTHER TIME DEPOSITS

REMAINS AT 15 PERCENT. THIS MEASURE WAS NOT SPECIFICALLY EXPLAINED BUT THE GENERAL THRUST OF THE ANNOUNCEMENT IMPLIED THAT A MONETARY CONTRACTION IS A NECESSARY ADJUNCT TO THE GOG'S ANTI-INFLATION PLANS. (C) REQUIRE BANKS TO REDUCE INVESTMENT IN WAREHOUSE BONDS AND LOANS AGAINST WAREHOUSE BONDS TO 25 PERCENT OF CURRENT LEVEL. REDUCTION WILL BE MADE GRADUALLY AS LOANS MATURE. AN EXCEPTION TO THIS REQUIREMENT WILL BE MADE FOR WAREHOUSE BONDS ON EXPORT PRODUCTS. NO EXPLANATION WAS GIVEN FOR THIS CHANGE. (D) ALL GOVERNMENT BONDS, WHICH PAY 8 PERCENT, WILL CARRY REPURCHASE PROVISION. IN PRESENTING THE PACKAGE, MONETARY BOARD SPOKESMEN DECLARED THAT GUATEMALA'S NET INTERNATIONAL RESERVES REMAIN AT RECORD LEVELS AND, ACCORDINGLY, GOG IS NOT CONTEMPLATING RETURN TO EXCHANGE CONTROLS. (END UNCLASSIFIED)

2. COMMENT: BEGIN LIMITED OFFICIAL USE) PACKAGE FOLLOWS SEVERAL MONTHS OF RUMORS ABOUT HOW GOG PLANNED TO ADJUST ITS MONETARY POLICY IN FACE OF WORLD CRISIS AND DOMESTIC "ANTI-INFLATION" POLICY. THERE VERY DEFINITELY HAS BEEN SOME CAPITAL FLIGHT ATTRACTED BY HIGHER INTEREST RATES ABROAD. MORE SIGNIFICANT, BUSINESS HAS BEEN ON AN INVENTORY BUILDING SPURGE PROMPTED BY FEARS OF FURTHER INFLATION AND SCARCITIES WITH RESULT THAT IMPORTS HAVE SOARED. NET INTERNATIONAL RESERVES PROBABLY DO REMAIN AT RECORD LEVELS (LATEST DATA AVAILABLE TO EMBASSY IS FOR END JULY AND THUS IRRELEVANT TO CURRENT DISCUSSION) BUT PROBABLY ARE FALLING FAST. WITH REGARD TO THE APPROPRIATENESS AND EFFECTIVENESS OF NEW MEASURES, EMBASSY WOULD CONCLUDE THAT THEY ARE STEPS IN RIGHT DIRECTION BUT FALL SHORT OF NEEDS OR COME TOO LATE. FIRST, INTEREST RATES ON LOANS/DISCOUNTS STILL RELATIVELY LOW AND THEREFORE UNLIKELY TO SERVE AS DISINCENTIVE TO SPECULATIVE BUYING. FURTHERMORE, MAINTENANCE OF SEPARATE RATE SCHEDULE FOR BASIC GRAINS LOANS IS OPEN INCENTIVE FOR LARGE PLANTERS TO BEAT THE SYSTEM. AS SOMEONE SAID, MONEY IS FUNGIBLE. RE NEW DEPOSIT RATE, FIRST PROBLEM IS THAT 9 PERCENT IS STILL WELL BELOW WHAT CAN BE OBTAINED ABROAD. SECOND, THE BANKS REMAIN VERY LIQUID (FREE RESERVES WERE ALMOST \$23 MILLION AT END JULY) AND THEREFORE DISCOURAGE NEW DEPOSITORS WITH RATES WELL BELOW THE PREVIOUS MAXIMUM OF 6 PERCENT. FOR A TIME AT LEAST, THE NEW RATES WILL SERVE ONLY TO CREATE WINDFALL PROFITS FOR THE BANKS (THEY'LL CHARGE 11 AND PAY FOUR OR FIVE.. AND WHEN/IF THE BANKS DO RAISE DEPOSIT RATE TO 9PERCENT, THEY

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WILL DRAW FUNDS FROM CLIENTS NOW HOLDING GOVERNMENT BONDS. IF BOG FOUND IT DIFFICULT TO SELL SUCH BONDS WHEN SPREAD BETWEEN DEPOSIT RATE AND BOND RATE APPROACHED 4 PERCENT, IT IS DIFFICULT TO IMAGINE ANYONE STAYING WITH BONDS WHEN THE DEPOSIT RATE IS HIGHER, EVEN IF THE BONDS DO HAVE A REPURCHASE AGREEMENT. A MORE EFFECTIVE MEASURE IS LIKELY TO BE THE RESTRICTION ON COMMERCIAL BANK TRANSACTIONS IN WAREHOUSE BONDS. USE OF BONDED WAREHOUSES HAS GROWN MARKEDLY LATELY, NOT ONLY BECAUSE, AS NOTED ABOVE,

IMPORTERS ARE STOCKPILING, BUT BECAUSE IT IS A RELATIVELY CHEAP WAY TO FINANCE IMPORTS. THE NEW MEASURE WILL CUT SUCH TRANSACTIONS DEAD IN THEIR TRACKS. THE PROBLEM HERE IS SIMPLY THAT THE PEAK MAY ALREADY HAVE BEEN PAST.

THE END AUGUST DATA SHOWED A \$9 MILLION DROP FROM JULY; AFTERALL, YOU CAN'T GO ON INVENTORY BUILDING FOREVER. FINALLY, WITH REGARD TO THE CHANGE IN RESERVE REQUIREMENTS WE SEE SEVERAL PROBLEMS. FIRST, USING END JULY DATA, THE INCREASE WOULD CAUSE A CONTRACTION OF ONLY ABOUT \$16 MILLION. THIS IS EQUIVALENT TO ONLY ABOUT 2.5 PERCENT OF TOTAL MONEY SUPPLY (M1 PLUS M2). EVEN ALLOWING FOR A GROWTH OF SIGHT DEPOSITS IN THE MONTHS AHEAD (A SEASONAL DEVELOPMENT THAT DOESN'T ALWAYS OCCUR), THE NET RESULT OF THE NEW MEASURE IS THUS UNLIKELY TO BE A SIGNIFICANT CONTRACTION. EVEN IF IT WERE, THE DECISION TO LEAVE RESERVE REQUIREMENTS ON SAVINGS AND TIME DEPOSITS UNCHANGED WOULD DEFEAT THE INTENT OF THE MEASURES; IN THE PAST, THE BANKS HAVE BEEN ADEPT AT PERSUADING CLIENTS TO SHIFT FROM HIGH RESERVE REQUIREMENT SIGHT DEPOSITS TO LOW REQUIREMENT SAVINGS ACCOUNTS WHEN FUNDS WERE NEEDED. IN SUM, TOO LITTLE AND TOO LATE.

3. NOT EVERYONE AGREES, OF COURSE. SEPT 28, EVEN BEFORE THE NEW MEASURES WERE ANNOUNCED, THE COFFEE ASSOCIATION APPEARED IN THE PRESS DENOUNCING PLANS TO RAISE INTEREST RATES. THEY'VE HAD A GOOD THING GOING HERE AND KNOW IT. AS AN ALTERNATIVE TO HIGHER RATES, THE ASSOCIATION SUGGESTED EXCHANGE CONTROLS. CONTROLS MAY WELL BE IN THE CARDS, BUT THE GOG WILL DRAG ITS HEELS UNTIL THE LAST POSSIBLE MOMENT, NO MATTER WHAT THE ASSOCIATION SAYS.

DECONTROL AFTER 9/30/76.
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